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No. 84-679

In The Supreme Court
Of The United States

October Term 1984

BATEMAN EICHLER, HILL RICHARDS, INCORPORATED, Petitioner,

vs.

CARL F. BERNER, et al., Respondents.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

BRIEF FOR RESPONDENTS

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QUESTIONS PRESENTED

1. Is there a need for an *in pari delicto* defense in an action brought by a "tippee" against his "tipper" under the antifraud provisions of the federal securities law after this Court's decisions in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), *Chiarella v. United States*, 445 U.S. 222 (1980) and *Dirks v. SEC*, 463 U.S. 646, 103 S.Ct. 3255 (1983)?

2. Assuming that a broker or corporate insider has encouraged investors to purchase securities based upon a representation that the investors are being given "non-public" information and such information is false and was made with the degree of *scienter* for which there would be liablity under this Court's decision in *Ernst & Ernst*, are the duped investors ever *in pari delicto*?

3. Is the defense of in pari delicto inappropriate as the sole basis for dismissal of a complaint in a private action under the federal securites laws, unless the alleged facts show that the investor is equally responsible for his injury? 1/

1/ Respondents-plaintiffs on whose behalf this brief is filed are Carl F. Berner, Charles Bruner, Dennis T. Demetre, Lawrence Epstein, Barry S. Glass, Herbert Greenbaum, Robert M. Jacobs, Arnold R. Keiles, Harry Mittleman, and Gary L. Nobel. Charles P. Lazzaro, Leslie L. Neadeau, and T.O.N.M. Oil & Gas Exploration Corporation, identified in the caption as respondents, are defendants.

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BRIEF FOR RESPONDENTS

STATEMENT OF THE CASE

Plaintiffs brought this action to recover damages arising out of their purchase of stock in T.O.N.M. Oil & Gas Exploration Corporation ("T.O.N.M."). The complaint was filed on December 10, 1982. (J.A. 1.) 2/

Plaintiffs' complaint alleged that, commencing in November, 1979, Bateman Eichler, Hill Richards, Incorporated ("Bateman Eichler"), a broker-dealer, Charles P. Lazzaro, its registered representative, T.O.N.M., a public corporation, and Leslie L. Neadeau, its president, engaged in a scheme to manipulate the market price of T.O.N.M. stock by disseminating false information on the pretext that it was "not public" information. (J.A. 10-15, Complaint ¶¶ 16, 23,

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2/ The J.A. references are to the Joint Appendix, with the number referring to the page number.

29.) This scheme involved representations concerning the business prospects for T.O.N.M. and the relationship between Lazzaro and T.O.N.M. (J.A. 10-13, Complaint ¶¶ 15-17, 19-22.) The representations are alleged to have been made by the defendants with the intention of inducing purchases of T.O.N.M. stock by plaintiffs for the purpose of creating an artificially high demand and price for T.O.N.M. stock. (J.A. 10-12, 15-16, Complaint ¶¶ 16, 29, 3/ 31, 34.) The representations are alleged to be false

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3/ Paragraph 29 of the complaint alleges that all defendants were involved in the misrepresentations to plaintiffs. Thus, although plaintiffs have alleged that Bateman Eichler has "control liability" as well (J.A. 7, 16, Complaint ¶¶ 5, 16-17), it would be inappropriate to draw a distinction at the pleading stage between the availability of in pari delicto for the representative and the brokerage house. For example, proof might show that the brokerage house was making a market in the stock.

(J.A. 15, Complaint ¶ 30) or materially incomplete (J.A. 15-16, Complaint ¶ 33). 4/ The defendants are alleged to have known the falsity of the representations. (J.A. 15, Complaint ¶ 32). The plaintiffs are alleged to have purchased

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4/ Bateman Eichler refers to the plaintiffs as having "actual" inside information throughout its argument. See, e.g., Brief of Petitioner at 12, 13, 15. The allegations of the complaint speak for themselves and the thrust of the allegations is that the information provided to plaintiffs was knowingly and intentionally false. (J.A. 13-14, 15, Complaint ¶¶ 23, 30, 32.) Plaintiffs' allegation that "T.O.N.M. announced that the negotiations for a joint venture had terminated and that no new negotiations were contemplated" (J.A. 13, Complaint ¶ 20) referred to by Bateman Eichler as support for its argument that plaintiffs had actual inside information (Brief of Petitioner at 15) does not establish that any such joint venture existed. In fact, that announcement would appear to be the perfect exit line for defendants' intentional manipulation. Nor does an allegation that plaintiffs were falsely advised that they were getting non-public information establish that the information was in fact non-public.

T.O.N.M. stock in reliance on defendants' misrepresentations and as a result of their unlawful scheme. (J.A. 10, 17, Complaint ¶¶ 15, 41a.) Plaintiffs' purchases of T.O.N.M. stock were made through the mechanism of the National Association of Securities Dealers over-the-counter system ("NASDAO"), a national securites exchange. (J.A. 10, Complaint ¶ 14.) And, finally the scheme produced a substantial manipulation in the price of T.O.N.M. stock. (J.A. 10, Complaint ¶¶ 14, 23.)

In short, plaintiffs alleged that they were used by defendants, without their knowledge, in an effort by defendants to manipulate the securities market in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. § 78j(b)), Securities and Exchange Commission Rule 10b-5

(17 C.F.R. 240.10b-5) and Section 17(a) of the Securities Act of 1933 ("Securities Act") (15 U.S.C. § 77q). 5/

The district court dismissed these claims under the doctrine of in pari delicto holding that "if the allegations of the complaint are true, both plaintiffs and defendants violated the particular statutory provision under which recovery is sought." (Pet. App. C-2, Order.)

Plaintiffs appealed the district court's decision and the Ninth Circuit reversed and remanded for a trial on the merits, holding:

> "We have concluded that the defense of in pari delicto is inappropriate as the sole basis for the dismissal of a complaint, in a private action under the federal securities

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5/ Plaintiffs raised additional claims that are not now in issue.

> laws, unless the alleged facts show that the investor is equally responsible for his injury. Where the pleaded facts show that the investor suffered a loss because he relied upon a broker's fraudulent misrepresentations, a cause of action has been stated which may be answered by denial or barred by pleading and proving an affirmative defense."

Pet. App. A-11, Opinion.

Bateman Eichler contends that, contrary to the law established by the courts of appeals in every other circuit which has considered the issue [6/] and contrary to the deep-rooted tradition of the common law, the Ninth Circuit

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6/ The Third Circuit in Tarasi v. Pittsburg National Bank, 555 F.2d 1152 (3d Cir.), cert. denied, 434 U.S. 965 (1971); the Fourth Circuit in Malamphy v. Real-Tex Enterprises, Inc., 527 F.2d 978 (4th Cir. 1975); the Fifth Circuit in Kuehnert v. Texstar Corp., 412 F.2d 700 (5th Cir. 1969); and the Eleventh Circuit in Silverberg v. Paine, Webber, Jackson & Curtis, Inc., 710 F.2d 678 (11th Cir. 1983).

decision has eliminated the in pari delicto defense in actions brought under Section 10(b) of the Exchange Act against broker defendants. It is apparent from the holding of the Ninth Circuit set forth above that this contention is greatly overstated.

The decision of the Ninth Circuit herein did not "sweep away" the in pari delicto defense. Rather, it recognized the defense, but held that "equal fault" within the meaning of the defense could not exist as a matter of law if the plaintiffs proved that they were used unknowingly by the broker defendants as part of a scheme to manipulate the market in certain securities as alleged in their complaint.

> "In the matter before us, the complaint alleges that the fraudulent scheme was originated by the broker and his coconspirators to manipulate the

market price of T.O.N.M. stock for their financial benefit. The complaint further provides that the investors acted in reliance on these representations without knowledge of the true facts. The allegations of the complaint, if proved, would demonstrate that the investors could not have been equally responsible for the injury they suffered as a result of this fraudulent scheme. Therefore, the complaint should not have been dismissed on the basis of in pari delicto."

Pet. App. A-6, Opinion.

SUMMARY OF ARGUMENT

Bateman Eichler has presented three questions for this Court to consider but they can be summarized as only two: (1) does the common law in pari delicto defense apply to implied private anti-fraud actions under the federal securities laws and (2) if so, are the plaintiffs barred from proceeding with such an action because as "admitted tippee-securities law violators" they are

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"substantially equal" in fault to the defendants.

Plaintiffs' answer to the first question is that to date no circuit court, including the Ninth Circuit, 7/ has said that it does not apply. Thus, a substantial part of Bateman Eichler's argument 8/ is really not relevant to this Court's review of the Ninth Circuit decision because it considered in pari delicto as a possible defense in implied private actions under Section 10(b) of the Exchange Act.

However, plaintiffs respectfully submit that after this Court's decisions

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7/ Plaintiffs did argue in the Ninth Circuit that the court should reject the in pari delicto defense in Section 10(b) cases as a matter of enforcement policy but the Ninth Circuit's holding did not go that far.

8/ Brief of Petitioner at 18-43.

in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), Chiarella v. United States, 445 U.S. 222 (1980) and Dirks v. S.E.C., 463 U.S. 646, 103 S.Ct. 3255 (1983) the question of whether in pari delicto is an available defense in an action brought under Section 10(b) of the Exchange Act by a "tippee" against his "tipper" has been rendered moot. If the basis of the claim is a negligent misrepresentation it is no longer actionable and if the basis of the claim is an intentional misrepresentation the "tippee" has no duty to disclose false information, the breach of which would make him in pari delicto.

Even assuming a duty to disclose false information, however, plaintiffs' answer to the second issue is that a duped investor is never in pari delicto with someone who, from the outset, is intentionally defrauding him.

Finally, if such parties could be considered in pari delicto this Court should determine that public policy considerations with respect to protection and enforcement objectives for the federal securities laws militate against permitting the defense.

ARGUMENT

I. There Is No Need for an In Pari Delicto Defense in an Action Brought by a "Tippee" Against His "Tipper" Under the Antifraud Provision of the Federal Securities Laws.

This case, like the majority of the cases that have considered the question of whether the doctrine of in pari delicto provides a defense to an action under Section 10(b) of the Exchange Act, involves alleged "tippees" seeking to recover their trading losses from their "tippers" because the tip proved to be false.

Prior to this Court's decision in Ernst & Ernst no distinction was made between negligent and intentional conduct with respect to a false representation. Without such a distinction application of the in pari delicto doctrine was the only way to give consideration to transactions where a "tip" proved to be wrong but the "tipper" did not intentionally provide false information to his "tippee". Under these circumstances, the doctrine of in pari delicto would generally provide a defense because the "tipper's" and "tippee's" conduct could be viewed as "clearly mutual, simultaneous, and relatively equal". 9/

9/ Woolf v. S.D. Cohn & Co., 521 F.2d 225, 227 (5th Cir. 1975), citing James v. DuBreuil, 500 F.2d 155 (5th Cir. 1974).

But, such a defense is no longer necessary because the conduct of the "tipper" is no longer actionable unless he has acted with the requisite degree of scienter required by Ernst & Ernst. 10/

It is under circumstances where the "tip" proves to be intentionally false that consideration of in pari delicto as a defense has presented more difficulty to the courts. And, it is the cases of intentional misrepresentation between "tipper" and "tippee" where the courts have split in determining whether the

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10/ Cf. discussion in Sunstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1048 (7th Cir.), cert. denied, 434 U.S. 875 (1977) and Holdsworth v. Strong 545 F.2d 687 (10th Cir. 1976) admitting the weakening of the due diligence defense because of Ernst & Ernst's scienter requirement.

parties are in pari delicto. 11/ However, this Court need not consider whether the Ninth Circuit's determination that it would not find plaintiffs and their broker who intentionally provided false information in pari delicto as a matter of law or the Third Circuit's determination that it would is correct.

Just as the Ernst & Ernst decision has eliminated the relevance of an in pari delicto defense in actions under Section 10(b) of the Exchange Act where

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11/ Plaintiffs contend that the Ninth Circuit's decision that a "tippee" to whom a broker defendant is alleged and proved to have intentionally provided false information cannot be in pari delicto as a matter of law is in total harmony with the common law in pari delicto standard of requiring "clearly mutual, simultaneous and relatively equal" conduct. The conclusion that a person who is being deliberately provided a false "tip" is not involved in "mutual and simultaneous" conduct with the "tipper" seems obvious.

the information is not intentionally false, it is respectfully submitted that the Chiarella and Dirks decisions have eliminated the relevance of an in pari delicto defense in actions under Section 10(b) of the Exchange Act where the information is intentionally false.

In Chiarella, this Court held that the mere possession and use of non-public information does not result in liability under Section 10(b) of the Exchange Act in the absence of a corresponding duty to disclose the information. 445 U.S. 222, 231 (1980). In Dirks, this Court held that the existence of a duty for an alleged "tippee" was derivative from the duty owed by an "insider" to disclose the non-public information to those with whom he had a fiduciary relationship, i.e. the shareholders. 103 S.Ct. 3255, 3264 (1983).

Logic dictates that an insider cannot have a duty to disclose to his shareholders information which he knows to be false. Thus, the "tippee" who receives intentionally false information from an insider would have no derivative duty to disclose and could not violate the anti-fraud provisions of the securities laws with his attempted "inside trading". It would be a "legal impossibility" in the same sense as Bateman Eichler acknowledges existed in Silverberg and Xaphes v. Shearson, Hayden, Stone, Inc., 508 F.Supp. 882 (S.D. Fla. 1981). (Brief of Petitioner at 17, n.12.) 12/

Bateman Eichler urges this Court to conclude that application of its

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12/ See Notes, The Availability of the In Pari Delicto Defense in Tippee-Tipper Rule 10b-5 Actions After Dirks v. SEC, 62 Wash. U. L.Q. 519, 538-543 (1984).

decisions in Chiarella and Dirks to plaintiffs' conduct only requires a determination that plaintiffs knew that the "tip" came from an "insider" and that the "tip" was for an improper purpose, i.e., "pecuniary gain or a reputational benefit that will translate into future earnings", Dirks, 103 S.Ct. at 3265-66, and that therefore there was a duty to disclose.

This analysis reduces the duty to disclose to nothing more than an abstract concept. Plaintiffs do not believe this Court intended to define the duty to disclose with respect to possible violations of Section 10(b) of the Exchange Act arising out of the use of non-public information as a mere abstraction. The duty to disclose that the "insider" has must relate to specific information and it is impossible to see how there can be

a legal duty on the "insider" to disclose false information.

If this Court accepts Bateman Eichler's analysis and concludes that it is only necessary to find an "insider" duty to disclose in the abstract, the result will be that every insider will have carte blanche to defraud investors by inducing them to trade in securities with intentionally false tips. 13/ Such a result would be unconscionable and could not have been intended.

13/ If the insider provides intentionally false tips to an investor there could be little doubt that it would be for an "improper purpose" thereby satisfying the Dirks criterion and there would be no doubt that there would be a duty to disclose because the information would be coming from a known insider.

II. If a "Tippee" Receives Intentionally False Information In Pari Delicto Cannot Defeat His Claim Against His "Tipper" Because Their Conduct Is Not Mutual, Simultaneous and Relatively Equal.

Both Kuehnert v. Texstar Corporation, 412 F.2d 700 (5th Cir. 1969), and Malamphy v. Real-Tex Enterprises, Inc., 527 F.2d 978 (4th Cir. 1975), which Bateman Eichler contends supports its position, were decided before Ernst & Ernst. Thus, neither court was in the position to conclude as did the Ninth Circuit that scienter, if proved, would be inconsistent with the notion of "equal" fault. (Pet. App. A-10, n.2, Opinion.)

Moreover, neither the Fourth Circuit nor the Fifth Circuit have concluded that in pari delicto should be an absolute defense in a securities case without a

balancing of the relative fault of the parties. 14/

Silverberg v. Paine, Webber, Jackson & Curtis, Inc., 710 F.2d 678 (11th Cir. 1983), and Tarasi v. Pittsburg Nat'l Bank, 555 F.2d 1152 (3d Cir. 1977), were both decided after Ernst & Ernst. But, far from being in conflict with the decision of the Ninth Circuit herein, the decision by the Eleventh Circuit in Silverberg would appear to be completely consistent with the Ninth Circuit's conclusion that the defense of in pari

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14/ In Malamphy, the Fourth Circuit only concluded that it was not error to submit the defense of in pari delicto to the jury given the facts of the case. The Fifth Circuit's decision in Kuehnert has been clarified in two later cases -- James v. DuBreuil, 500 F.2d 155 (5th Cir. 1974) and Woolf v. S.D. Cohn & Co., 521 F.2d 225 (5th Cir. 1975) -- both of which adopt the standard of "clearly mutual, simultaneous and relatively equal" conduct for the defense of in pari delicto to be available.

delicto is inappropriate "unless the alleged facts show that the investor is equally responsible for his injury". (Pet. App. A-11, Opinion.) That is precisely what the Eleventh Circuit decided when it concluded that the facts before the court did not warrant giving an in pari delicto jury instruction. A comparison of the facts presented in Silverberg to the allegations of the plaintiffs' complaint demonstrates that they did not act any more culpably than Dr. Silverberg. 15/

15/ Bateman Eichler justifies the conclusion reached by the Eleventh Circuit in Silverberg by stating that because no insider was involved Silberberg had no Chiarella/Dirks duty to disclose. Plaintiffs do not dispute this conclusion and as is discussed above respectfully submit neither do they have such a duty. Nevertheless, the similarity of the fraud perpetrated on Silverberg to the fraud perpetrated on plaintiffs is striking.

The Third Circuit actually recognized that under the Ernst & Ernst decision the absence of an in pari delicto defense would have the greatest impact "on deliberate purveyors of false information", Tarasi, 555 F.2d at 1163, but in adopting its equal fault standard, concluded that the conduct involved was in the nature of "equal fault" when considered in light of this Court's discussion of "passive" or "coerced" conduct in Perma Life. 555 F.2d at 1162. The conclusion of the Third Circuit that "equal" fault existed in Tarasi must have resulted more from a narrow construction of the holding of Perma Life than an actual determination that the conduct of the parties was "mutual and simultaneous".

It is respectfully submitted that the common law doctrine which requires "clearly mutual, simultaneous and

relatively equal" conduct to sustain in pari delicto has not been modified by Perma Life to mean only non-passive and non-coerced conduct. A person who is deliberately duped simply cannot be said to be in pari delicto with "deliberate purveyors of false information".

III. The In Pari Delicto Defense Should Not Be Available to a Broker Defendant in a Section 10(b) Case.

A. The Enforcement Standard Articulated in Perma Life Mufflers, Inc. v. International Parts Co., 392 U.S. 134 (1968), Should Be Applied to Conduct of Broker Defendants in Circumstances of Equal Fault With Their "Tippees".

Although this Court has not ruled on the precise question of law, it has ruled on the application of the in pari delicto defense in the context of a federal regulatory scheme and private actions arising out of the federal regulations. It is respectfully submitted that the majority opinion in Perma Life Mufflers, Inc. v.

International Parts Corp., 392 U.S. 134 (1968), eliminated the application of the defense to private antitrust actions. 392 U.S. at 140. Simultaneous with the elimination of the defense was the adoption of a new standard for permitting recovery in circumstances of equal fault. 16/ As Justice Black explained:

> "We have often indicated the inappropriateness of invoking broad common law barriers to relief where a private suit serves important public purposes. . . . A more fastidious regard for the relative moral worth of the parties would only result in seriously undermining the usefulness of the private action as a bulwark of antitrust enforcement."

392 U.S. at 138.

16/ In Perma Life this Court actually found that on the facts the parties were not of "equal fault" because the plaintiffs had a weaker bargaining position and were coerced into accepting the overall contractual scheme. 392 U.S. at 139.

Most of the courts which have considered the in pari delicto defense in the context of a securities case have addressed the issue of whether this Court's Perma Life holding should be extended to the federal securities laws regulatory scheme. None of the courts, including the Ninth Circuit, have embraced the notion that the defense should be eliminated entirely. 17/ However, all of these courts have balanced some consideration of the so-called

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17/ As is argued above total elimination of the defense in the context of a case under Section 10(b) of the Exchange Act may already have been accomplished through narrowing of the scope of activity condemned and the scope of the duty to disclose with respect to the use of non-public information and identifying the derivative nature of the "tippee's" duty to disclose.

enforcement standard articulated by Justice Black. 18/

Thus in Tarsai, the Third Circuit interpreted its task in assessing the availability of in pari delicto as follows:

> "Perma Life thus appears to have restricted consideration of plaintiffs' illegal conduct as a defense without foreclosing cognizance of this factor altogether. A plaintiff's unlawful conduct must be

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18/ Bateman Eichler appears to suggest that any consideration of an enforcement standard is improper because the private right of action under the antifraud provisions of the securities laws is implied rather than statutory. The goal of preventing common law barriers to relief in a private suit which serves the important public purpose of a "bulwark" of enforcement is not different simply because the private action is specifically provided for in one regulatory scheme and judicially inferred in another. If anything, the public policy which sustains the inference of a private action for needed enforcement of the regulatory scheme would seem more likely to compel private action enforcement which is unfettered.

> active and significant before it can bar a verdict in his favor. However, Perma Life also teaches that prevention of unjust enrichment and protection of the integrity of the courts cannot, by themselves, thwart recovery in private actions under regulatory statutes. Accordingly, before denying recovery to a plaintiff, a court must carefully assess the impact of such a result on the enforcement of statutory schemes. [Footnote omitted.] This we shall now proceed to do."

555 F.2d at 1158-59.

And in Kuehnert, the Fifth Circuit held:

> "Although Kuehnert's status as a tippee makes the defenses of unclean hands and in pari delicto available, their application rests with the discretion of the court. [Citation omitted.] The question must be one of policy: which decision will have the better consequences in promoting the objective of the securities laws by increasing the protection to be afforded the investing public. [Citation omitted.]"

412 F.2d at 704.

All of the courts have recognized the need to apply an enforcement standard to some extent in analyzing the availability of in pari delicto. The only real question has been what is the proper policy to pursue regarding enforcement with respect to "tippers" and "tippees".

B. Protection and Enforcement of the Federal Securities Regulatory Scheme Is Best Served by Elimination of In Pari Delicto As a Defense Between a Broker Defendant Acting As a "Tipper" and His "Tippee".

Bateman Eichler contends that the Third and Fifth Circuits' analysis of the enforcement policy considerations is superior to that of the Ninth Circuit. 19/

The Ninth Circuit analyzed the enforcement policy issue at three levels: (1) it adopted an approach consistent

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19/ Brief of Petitioner at 10-11, 35-40.

with the Perma Life case's focus first on the deterrent effect on the defendant as opposed to a focus on what would encourage plaintiffs' compliance (Pet. App. A-8, Opinion); (2) it concluded that the compliance effect on plaintiffs was outweighed by resulting adverse consequences to the market and innocent investors (Pet. App. A-9, Opinion); and (3) it recognized the absence of any absolute warranty ("heads I win, tails you lose") 20/ with respect to a "tip" in light of the exclusion of innocent or negligent misrepresentation from actionable claims under Section 10(b) of the Exchange Act

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20/ The only warranty the"tippee" receives is that no intentional misrepresentations will be made to him. Contrast this to the warranty an insider receives in the presence of the in pari delicto defense -- he may attempt to defraud with absolute and total impunity against a private civil action. See discussion in part I above.

after Ernst & Ernst. (Pet. App. A-10, Opinion.)

The courts in the cases relied upon by Bateman Eichler have concluded that enforcement is best served by a balance of sanctions between "tipper" and "tippee" and contend that there are adequate statutory deterrents to "tippers". The theory is that these deterrents will come into play because the "tippers" are "highly visible" whereas the "tippees" are not.

> "Elimination of the defense would remove the most effective disincentive against the 'tippee's' use of inside information. Because of the tippee's relatively low visibility, the threat of discovery and potential liability is slight. By contrast, 'tippers' are usually highly visible officers, directors or brokerage firms, subject to extensive statutory disclosure requirements, SEC enforcement actions and private

> suits by non-'tippee' purchasers or sellers."

In re Haven Industries, Inc., 462 F.Supp. 172, 180 (S.D.N.Y. 1978). 21/

There are two essential fallacies in an analysis which concludes that the

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21/ The difference between Judge Gagliardi's approach to enforcement policy and the Ninth Circuit's exemplifies the only real difference between the cases which allow the in pari delicto defense and those which deny it. Those cases allowing the defense focus upon deterring the tippee from taking a tip. Those cases denying the defense focus upon deterring the tipper from giving the tip. Numerous commentators have discussed this essential difference and have concluded that the proper focus is on deterring the giving of the tip. See, Comments, Rule 10b-5: The In Pari Delicto and Unclean Hands Defenses, 58 Calif. L.R. 1149, 1159-60 (1970); Schiebelhut, The Demise of In Pari Delicto in Private Actions Pursuant to Regulatory Schemes, 60 Calif. L.R. 531 (1972); Comments, Availability of an In Pari Delicto Defense in Rule 10b-5 Tippee Suits, 77 Col. L.R. 1084, 1097 (1977); Murray, Securities Regulation - In Pari Delicto as a Bar to Private Antifraud Action by Tippee Against Tipper, 43 Mo. L.R. 378, 386-387 (1978).

deterrent effect must be placed upon the taker of the tip in order to equalize or maximize the possible deterrent effect on both the "tipper" and the "tippee". The first fallacy is that the "tipper" has himself necessarily acted upon the information in the tip and therefore is "highly visible" and subject to discovery through other types of proceedings. The second fallacy is that "tippees" respond to the deterrent effect of not being able to recover on a false tip. Two simple illustrative scenarios demonstrate these fallacies.

Assume that a "tippee" receives a true tip from a corporate insider. The "tippee" then goes to his broker and either purchases or sells depending on the tip. A member of the investing public without the tip suffers a loss in the transaction. The "tippee" makes an

illegal profit and because of his alleged remoteness [from the insider group] he goes undetected. Query: how is the "tipper" in this transaction "detected" so that the so-called "substantial deterrents to 'tippers' . . . in the form of SEC and criminal actions as well as private suits by non-'tippee' purchasers and sellers who have been adversely affected" (In re Haven Industries, Inc., 426 F.Supp. at. 180) come into play? The insider has not engaged in any transaction which identifies him. Surely we are not to assume that the "tipper" has announced to the world that he illegally gave a tip. In fact, the only link the insider has to any wrongdoing which could trigge. either governmental investigation or a private suit by the injured non-tippee is through the "tippee", who according to the theory is difficult to

discover. Thus, when an insider gives a true tip and does nothing further, he is probably more remote than his "tippee" in terms of discovery.

Even if the insider "tipper" actually trades in the stock, and therefore might truly be said to be highly visible, and, in fact, is actually identified, there is certainly no reason to believe that the investigation (either public or private) cannot go one step further with the insider identifying those people to whom he gave his information.

Now assume that a "tippee" receives a false tip from a corporate insider. The "tippee" then goes to his broker and either purchases or sells depending on the tip. A member of the investing public without the tip suffers no loss in the transaction. In fact, the "tippee" suffers a loss. Both the "tipper" and

the "tippee" are alleged to have violated the law but the entire transaction goes undetected. Understandably the "tipper" has no incentive to inform the governmental regulators that recent activity in his corporation's stock resulted from false tips he disseminated. And, if the "tippee" is precluded from asserting a claim for his damages, he has no incentive to inform the regulators about the tip. In fact, the very reason the "tippee" is being denied the right to assert his claim -- his own conduct is illegal under the securities laws -- assures that the "tippee" will not advise anyone of the transaction. 22/

22/ As one commentator suggests:

"A plaintiff who may be at fault to some degree cannot be expected to assume the expense of

[FN. CONT'D. ON FOLLOWING PAGE]

Significantly, however, although the individual members of the investing public who trade with the "tippee" with false information suffer no individual damages, the market for the stock has been adversely impacted and members of the investing public generally may suffer damage because they are trading in a stock the market for which has been artificially manipulated. This, of course, is one of the principal abuses which the Exchange Act sought to prevent by Section 10(b).

> bringing an action and the risk of exposing himself to potential liability unless there is a strong indication that the law will offer the appropriate encouragement by barring the [in pari delicto and unclean hands] defenses."

Comments, Rule 10b-5: The In Pari Delicto and Unclean Hands Defenses, supra, at 1158.

Moreover, the only way the so-called deterrent effect of denying recovery to the "tippee" can possibly discourage the taking of a tip, is if it is assumed that most "tippees" approach the tip assuming it is false. Under the reasoning of the courts permitting the defense, if the "tippees" believe the tip is true they believe they are "remote" in terms of discovery.

Suffice to say that notwithstanding their broker and insider status the SEC does not view these "tippers" as "highly visible" and that is one of the reasons it believes that the defense of in pari delicto should not be permitted to discourage "tippee" suits.

Bateman Eichler contends that the investor "tippee" is at least equally culpable with the scheming broker or corporate insider because the investor is

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the very person who directly causes the damage to the securities markets. The answer is that there will be no takers of tips if there are no tips. The opposite is not true. And, if brokers and corporate insiders are protected by the doctrine of in pari delicto even when they disseminate deliberately false tips to manipulate the market, an abundance of such tips will always exist in the hopes that some unsuspecting investors will appear.

CONCLUSION

Bateman Eichler has attempted to make the Ninth Circuit decision appear reckless, poorly reasoned and in conflict with both common law and the majority of case law. It is respectfully submitted that the decision stands up to all of these attacks. Moreover, the decision reaches the result which this Court's

decisions in Ernst & Ernst, Dirks and Chiarella support. Respondents respectfully pray that the judgment of the Ninth Circuit be affirmed.

Dated: March 27, 1985

Respectfully submitted,

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State of California)
) ss.
City and County of San Francisco)

Josie Strupaitis, being first duly sworn upon oath, deposes and says:

That affiant is a citizen of the United States, over 18 years of age, and not a party to the within cause; that affiant's business address is 862 Folsom Street, San Francisco, California 94107; that affiant served three (3) true and correct copies of the attached **Brief For Respondents** on each of the following persons, by placing same in envelopes addressed as follows:

Robert S. Warren, Esq.
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that said envelopes were then, on March 27, 1985, sealed and deposited in the United States Mail at San Francisco, California, with the postage thereon fully prepaid; and that there is delivery service by United States Mail at the place so addressed, or that there is regular communication by mail between the place of mailing and the place so addressed.

Jean Stergiotis

Subscribed and sworn to
before me this 27th day
of March, 1985

Arthur L. Martin
Notary Public in and for
the City and County of
San Francisco, State of
California

ARTHUR L. MARTIN
NOTARY PUBLIC - CALIFORNIA
CITY & COUNTY OF SAN FRANCISCO
My Commission Expires December 26, 1986